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FORTUNE

THE 25 YEAR OLDS

Today's young managers
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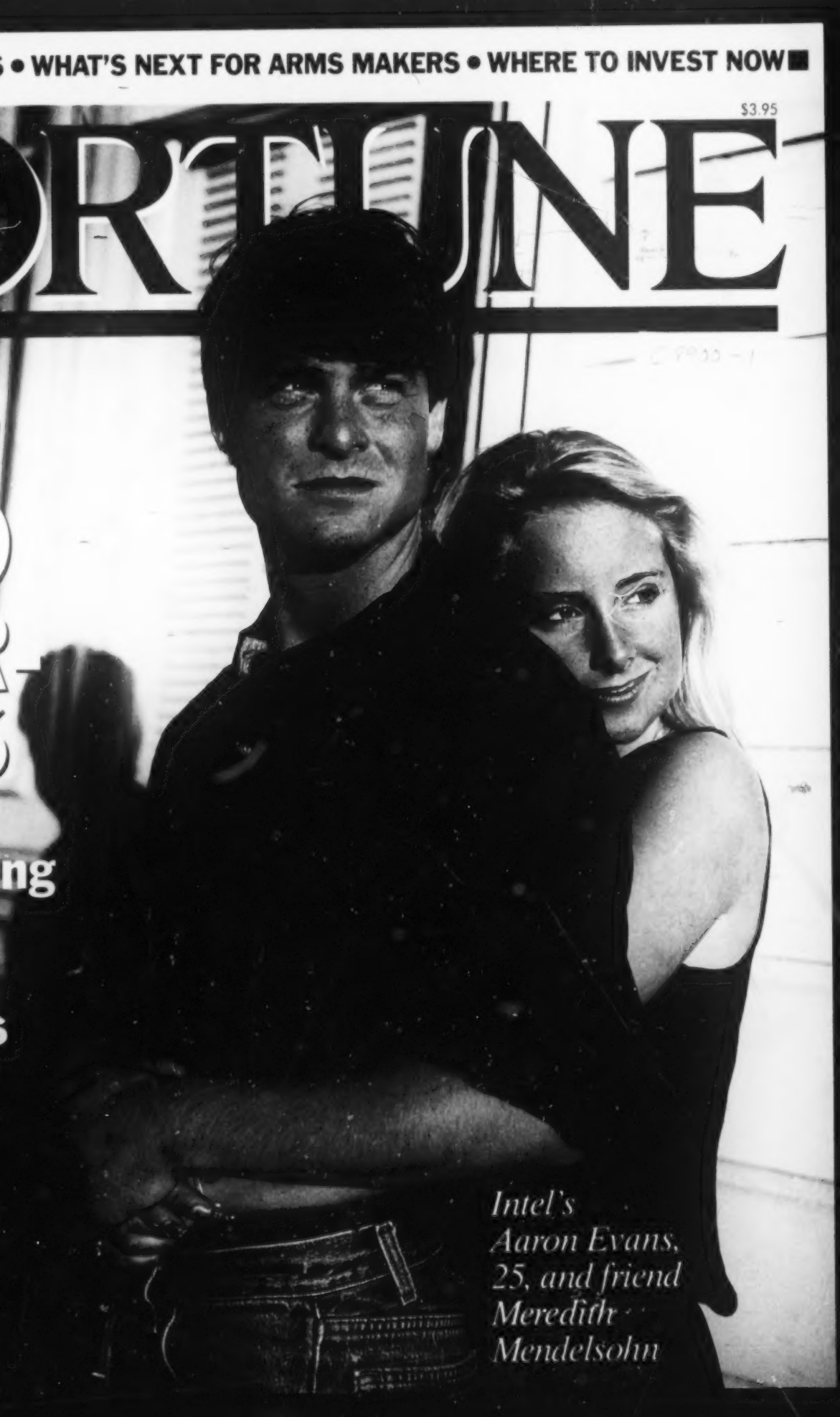

Intel's Aaron Evans, 25, and friend Meredith Mendelsohn

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AUGUST 27, 1990 VOL. 122, NO. 5

FORTUNE

"The older managers think that if the shoe doesn't fit, you should wear it and walk funny. The baby-busters say to throw it out and get a new shoe." PAGE 42

ABOVE: Tim Connell, a Georgia-Pacific manager, with his wife, Lisa. Photograph by Alen MacWeeney.

COVER: MacWeeney also took this shot of Evans, a microelectronics salesman, and Mendelsohn.

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WHAT 25-YEAR-OLDS WANT 42

Here come the baby-busters, and they are nothing like the workaholic yuppies who preceded them. The new crew have been known to turn down big promotions or to quickly acquire clout and then give it all up for leisure. Young, well-trained recruits are in short supply now, and the world should be their oyster. Meet the Employees Who *Can* Say No. *by Alan Deutschman*

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The combative Hugh McColl has built NCNB into the biggest bank in the Lone Star State and the sixth largest in the whole U.S. He's smart, he's bold, and he's the Resolution Trust Corp.'s best customer. *by Gary Hector*

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No, the big insurer isn't adding overhead. It is moving shrewdly to broaden its financial services business. *by Terence P. Paré*

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"Once you stop growing, you start dying."

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"Loyalty is not a character flaw."

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"Defense contractors that aren't marketing oriented are going to find themselves on the outside looking in."

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"He'll plant 50-foot palm trees. The rest of us buy 20-foot palms and hope they'll grow."

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"Right now, I know more about drinking Pepsi than I do about running it. But that will change fast."

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"The S&L debacle may be only a prelude to a far larger crisis in American financial institutions."

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No one else in North America controls a single property of such vast size and potential: 100 square miles of mostly raw land sitting squarely in the path of Los Angeles' southward sprawl. Worth $2 billion now, Donald Bren promises to keep his wealth climbing with his "build and hold" strategy. *by Gary Hector*

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EDITOR'S DESK

JAKE WYMAN

Cover story author Alan Deutschman (top left) and FORTUNE staffers who are 25 or less

HENRY LUCE was only 24 and Britton Hadden barely 25 when those two daring Yale grads first published *Time*—and launched our parent company in 1923. So we at FORTUNE have a special respect for what people can accomplish at that early age. Just consider the many companies started by visionaries 25 and under: Apple Computer, R.J. Reynolds, Sears Roebuck, Grey Advertising, Microsoft, Hallmark—and more.

JIM KOMENICH

Writer Gary Hector

Right now, the 25-year-olds are the cutting edge of a new generation: the baby-busters. And as our reporter Alan Deutschman, himself 25, discovered after weeks of interviewing them, they are "profoundly different" from the yuppies of the baby boom. No longer is careerism king: Independence and self-fulfillment have replaced that Eighties obsession. As smart young workers become one of our scarcest resources, today's executives would be wise to understand them. Step one: See our cover story on page 42.

Also in this issue, our prolific associate editor Gary Hector corrals two of America's most successful business leaders. First he tells how a tough Marine from North Carolina named Hugh McColl lassoed the largest bank in Texas and is building a herd to rival the national big boys. Then, in the real estate arena, Hector profiles billionaire developer Donald Bren, who is reshaping a large part of Southern California. Although McColl and Bren are both hard to pin down for interviews, Hector got them. He started talking with Bren last year and even followed him over a six-foot chain-link fence to get the scoop. For an inside perspective on folks who will mold tomorrow's world of business, read on.

Marshall Loeb

MANAGING EDITOR

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THE ARMS MAKERS' NEXT BATTLE

Still facing budget cuts and foreign competition, U.S. defense contractors are learning to fight enemies they should have taken on years ago: mismanagement and waste. ■ *by Nancy J. Perry*

THE LONG-TERM future is dark for defense contractors—but don't expect the big guns to admit it. "We're one of the strongest companies in terms of programs with high national priority," says Lockheed Chairman Daniel M. Tellep. "Because of the programs we're in and not in, we have a particularly good chance," says Grumman Chairman Renso L. Caporali. "General Dynamics has positioned itself in the heartland programs of all three services," says Chairman Stanley C. Pace.

The latest crisis in the Middle East is the only bracing news these guys have had in months. Within 48 hours after Iraq invaded Kuwait, defense stocks had risen 5%, and Congress was reconsidering previous plans to cut the military budget. Certainly the U.S. will need strong, mobile defenses to fend off the dangers of a post–Cold War world. But most of the cuts will still be made.

And with too many companies chasing too few programs, somebody will have to go. That somebody, the contractors say, is somebody else. Observes Under Secretary of Defense John Betti: "They are going through the first stages of competition shock. It's like the five stages of death. The first is disbelief."

Shrinking worldwide defense budgets, increased competition abroad, tougher government procurement policies, and the unnerving loss of a well-defined superpower enemy are rocking the defense industry like a barrage of multiwarhead missiles. To survive, contractors are learning to drop a few bombs of their own: laying off thousands of employees, closing underutilized plants, refusing to bid on unprofitable contracts, and becoming pickier about their own suppliers.

In the battle for market share that is heating up around the globe, the most efficient, highest-quality defense contractors will have the edge. The days of "bidding bellybuttons"—inflating job costs to cover the number of employees on the payroll—are over. Says John D. Rittenhouse, senior vice president of GE Aerospace: "In the future companies that focus on cost and performance will be around. Those that don't, won't. The basic principles of free enterprise are at work, and there's nothing wrong with that."

Farsighted companies are getting in fighting form now—before the big weapons chill sets in. In Defense Secretary Richard Cheney's fiscal 1991 budget request, money for procurement, research, development, testing, and evaluation—the part of the defense budget that most directly affects the industry—is down 6% in real terms, to $116 billion. On the day after the invasion of Kuwait, President Bush reaffirmed the Pentagon's proposal to cut the armed forces by 25% over five years.

The impact of these reductions will not be felt immediately. Contractors are still living off a $257 billion backlog of orders for which money has already been appropriated. Also, Washington being Washington, it is far from clear which weapons systems will be canceled. In his fiscal 1990 budget request, Cheney eliminated funding for 12 Grumman F-14D Navy fighters. Congress not only restored them but added another six, with the proviso that the program be terminated in 1991. Such wrangling—which

MARK RICHARDS—SIPA

For some military airplane makers the future rides on the Advanced Tactical Fighter. Above: Northrop's version.

McDonnell's Long Beach, California, factory can make 29 C-17s a year. Total order so far: six.

stands to increase as a result of the Middle East crisis—gives companies time to regroup.

Or rather it gives them *more* time. Defense executives have long been aware that the business is nosing downward. Since 1985, the peak year of the Reagan buildup, budget authorization for procurement, research, testing, development, and evaluation has dropped on average 4.5% a year in real terms. Over the next few years production will slow down or stop on major weapons programs such as General Dynamics' M-1 tank and F-16 fighter plane, McDonnell Douglas's F-15 fighter, Grumman's F-14D fighter and A-6 attack bomber, and Lockheed's F-117 Stealth fighter.

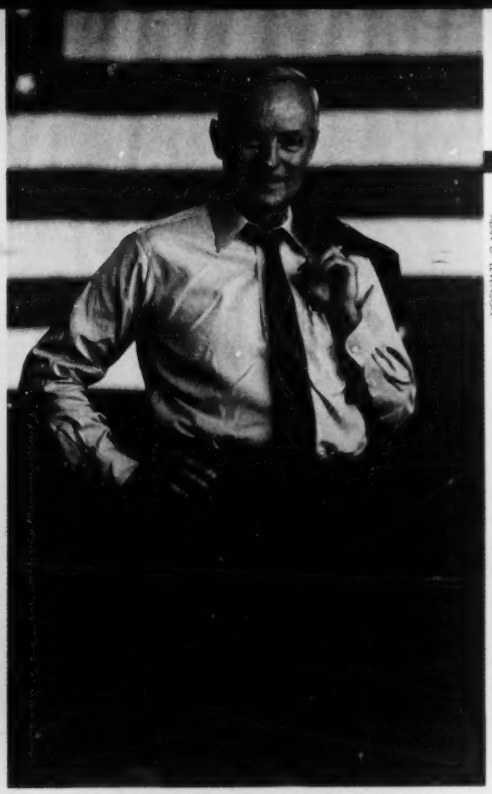
Despite the early warning, most weapons makers have not spent recent years transforming themselves into lean, mean fighting machines. Instead, they've been on the defensive, squabbling with Uncle Sam about a series of tax and procurement reforms that they say have hurt worse than budget cuts. The most onerous was the initiation in the early 1980s of so-called fixed-price development contracts. Unlike the lucrative cost-plus contracts of the past, these pay a set price regardless of how high expenses rise. In efforts to tap the Pentagon's dwindling reservoir of new, big-ticket weapons programs, contractors grossly underestimated the cost of development, bid low—and soon had billions of dollars of write-offs to show for it.

They also wound up with something else: a huge residue of debt. Bear Stearns reports that from 1986 to 1989 industrywide interest expense doubled to $1.7 billion annually. Part of that reflects heavy investments in plant and equipment during the Reagan years. But the Defense Department admits it is partly to blame. Says Betti: "The government has made inappropriate use of fixed-price development contracts by putting the risk on the supplier." The Pentagon will go back to the cost-plus model on some of its new contracts.

DEFENSE COMPANIES are now on the offensive in a war they should have been fighting all along—the campaign against mismanagement, shoddiness, and waste. "We need to do better," says McDonnell Douglas Chairman John McDonnell. Observes Rob-

REPORTER ASSOCIATES *Shelley Neumeier and Charlotte Faltermayer*

CRAIG MOLENHOUSE



ALAN D. LEVENSON

Lockheed's Tellep wants to operate airports.

ert Paulson, head of McKinsey & Co.'s worldwide defense practice: "There are proactive steps that companies can take to be players in the year 2000." Here's how weapons makers are girding for the new era:

■ **PICKING PRIORITY PROGRAMS.** This is easier said than done, for two reasons. One, there is no longer a consensus on who, or how dangerous, the enemy is. The defense industry, for all its radarscopes, is embarrassingly short on vision. Two, even if companies could figure out what to make, General Dynamics couldn't simply turn its M-1 tank factory into an assembly line for target drones. Says Boeing Chairman Frank Shrontz: "All companies are victims of where they happen to be at this point in time."

The future of the biggest prime contractors and their suppliers depends largely on the fate of four major new procurement programs—together valued at more than $200 billion—that are under congressional scrutiny. They are Northrop's B-2 Stealth bomber, the McDonnell Douglas C-17 military transport plane, the McDonnell Douglas–General Dynamics A-12 attack bomber, and the Advanced Tactical Fighter, for which contractors have yet to be chosen. Industry experts predict that at least one prime contractor will leave the overcrowded military airframe business by the end of the decade—probably Grumman, Northrop, or Lockheed.

Which company pushes the eject button could depend largely on the race for the Advanced Tactical Fighter contract, which could be worth more than $55 billion over the next 20 years. Two teams are competing: Northrop and McDonnell Douglas vs. Lockheed, Boeing, and General Dynamics. The winning design will be chosen in a fly-off pitting prototype against prototype next April.

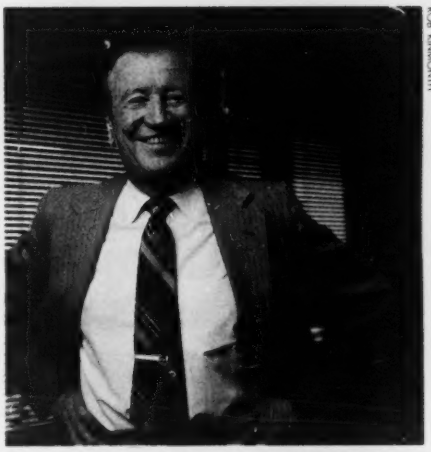
If Lockheed's team loses, the company will likely jettison its money-losing plane-building operation and concentrate on missiles and space, which contribute half of Lockheed's $10 billion in sales and practically all its profits. A smaller Lockheed might be open to a merger—perhaps with a company such as teammate General Dynamics, which has a strong balance sheet and wants to stay in the defense game. CEO Pace says General Dynamics is sizing up prospects but won't make any acquisition decisions until it sees which programs survive the next few years: "It is very risky to acquire now. You could win big or lose big."

If the other team in the ATF competition loses and the B-2 bomber also is killed, $5.2-billion-a-year Northrop could implode. Chairman Kent Kresa says his company has no plan for what it will do if it loses both contracts. But he speculates that it could carry on making airplane parts and electronic systems—on the scale of perhaps $3 billion a year. Potential buyers for such a company: Boeing, which wants to stay in defense as a way of hedging against the ups and downs of the commercial airliner business, and Rockwell International, a company that could use Northrop's technology to complement its own electronics business.

If nobody captures the ATF contract—if the project is killed or delayed—the winners will be McDonnell Douglas and Grumman,

ALAN D. LEVENSON

Northrop's Kresa is banking on the B-2 bomber.



ROB KINGHORN

Pace says General Dynamics will stick to defense.

which make the fighter jets that the ATF is meant to replace.

Defense contractors have been searching, largely without success, for havens free of competition. Many expanded into defense electronics, for instance, on the theory that as the Pentagon buys fewer ships, planes, and tanks, it will pay to upgrade systems on the ones it has. While a safer bet than trying to market aircraft carriers, the strategy has not paid off as well as expected. Lockheed, for example, has been frustrated by the lackluster growth of its 1986 electronics acquisition, Sanders Associates. A shakeout in

McDonnell plans to fire up to 17,000 workers.

KEITH SKELTON—MCDONNELL DOUGLAS

defense electronics seems inevitable.

Contractors also have been looking overseas to make up for lost business. In July, General Dynamics won permission from the government to deliver 315 heavy tanks to Saudi Arabia beginning in 1993. That will allow America's only tank producer to keep its M-1 assembly plant in Lima, Ohio, open after its Army contract expires next year.

But the international arms trade is hardly a competitive cease-fire zone. Countries such as Britain, France, and Brazil have stepped up military sales efforts; meanwhile, countries that have long been customers, such as Pakistan, Egypt, and Taiwan, have started building weapons of their own. Total arms sales to the Third World dropped 26% last year, to $29.3 billion. Faced with what is increasingly a buyers' market, U.S. defense contractors will have to fight harder just to keep the business they've got. A harbinger: Since 1985 the U.S. share of world military aerospace sales has fallen 12 percentage points, to 61%. Says Rockwell's retired chairman, Robert Anderson: "There's a heck of an arms bazaar out there."

The best alternative may be to avoid the crowd by concentrating on niches that stand to stay strong into the next century: nonnuclear missiles; lighter tanks, planes, and artillery; "smart" munitions that can locate targets themselves; antisubmarine warfare equipment; combat-simulation software for training; and information technology. Northrop's strategy is to identify characteristics that will be common to many future weapons—such as the ability to fool radar or to navigate with extreme precision—and develop corresponding products. Says Kresa: "If you are ahead in those areas, you'll be in a business everybody wants to buy in the future."

■ CAPITALIZING ON CASH. Arms makers are waking up to the basics of managing in a shrinking market. Says Paul Wright, chairman of Chrysler Technologies: "In the future we will be an industry measured much more on return on equity and profitability than growth, and that's a change in attitude."

Take Grumman. The future is uncertain at best for its biggest moneymaker, the F-14D, and Grumman's income statement is weighted with annual interest charges of $120 million on nearly $1 billion in debt. Says John O'Brien, Grumman's feisty ex-CEO: "We are recognizing there is significant money to be made by managing cash."

That means taking elementary steps to cut costs. The company, which processes around 50,000 invoices per month, recently finished automating its billing system. Grumman also is offering a discount to the government if it pays bills within ten days of delivery. So far the company has been able to shed $60 million of its debt.

One step that Grumman has refused, but that financial analysts say is inevitable, is to cut back operations on Long Island, the company's highest-cost location. Lockheed, on the other hand, is selling $200 million worth of plant and office space in Burbank, California—as well as cutting 5,500 jobs, 7% of the company's work force. CEO Tellep figures this "very bold decision" will save Lockheed $50 million annually and eliminate $75 million in capital investment over the next three years. Part of the aeronautics group is moving into Lockheed's underutilized plant in Georgia—home, as luck would have it, of Senate Armed Services Committee Chairman Sam Nunn.

■ DRAFTING DOABLE DESIGNS. A Boeing analysis of MX missile production five years ago showed that the step from drawing board to factory was appallingly inefficient. Thousands of engineering drawings were needed for the project; the average one had to be revised 11 times after hitting the factory floor; each revision cost an average of $5,000. Now Boeing and other defense contractors are trying a new approach: doing designs right the first time.

Engineers designing a weapon used to whip up drawings and hand them off to colleagues at the factory, whose job it was to figure out how to build the new device. Often they couldn't—and the process came to a halt while blueprints went back to the designers for revisions. Lately weapons makers have adopted a practice widely used by civilian technology companies such as Hewlett-Packard and AT&T. Known as concurrent engineering, it involves getting design and manufacturing engineers simultaneously to design a product and the process to make it. Thomas Murrin, a former adviser to the Pentagon who is Deputy Secretary of Commerce, says this approach can cut in half the time it takes to make a new weapon operational.

Boeing's Ballistic Systems Division employed concurrent engineering in 1988 to develop a mobile launcher for the MX. A team of design engineers and specialists in manufacturing, materials, finance, and maintenance shared office space and worked together from the beginning. Boeing used the original MX project for comparison. The outcome: a 40% reduction in the time needed to design and build the launcher prototype, and a 10% reduction in cost.

■ SUPPORTING SUPPLIERS. At Texas Instruments' avionics group near Dallas, managers realized that to be competitive TI needed to bind itself more closely to its best suppliers. TI enlisted them in an ambitious quality-assurance program, training the suppliers' technicians in statistical process control and certifying them to monitor their own products. Everybody wins: Suppliers who participate capture a greater share of TI's business, while TI avoids the expense of retesting every component that comes into its factories. (It still does spot checks.)

Because suppliers rarely have an opportunity to see their products in action, TI last

THE TOP TEN DEFENSE SUPPLIERS

COMPANY primary military products	1990 est. revenues from govt. sales (in billions)	Percent of total sales
McDonnell Douglas airplanes, missiles, helicopters, electronics, space	$10.2	67%
Lockheed airplanes, missiles, electronics, space	$9.0	91%
General Dynamics airplanes, submarines, tanks, missiles, space, electronics	$8.6	87%
General Electric engines, electronics	$8.2	18%
Boeing airplanes, helicopters, missiles, space	$5.6	20%
Martin Marietta missiles, electronics, space	$5.4	90%
Rockwell International electronics	$5.3	44%
General Motors (Hughes) electronics, space, missiles	$5.2	4%
United Technologies engines, helicopters	$5.2	24%
Northrop airplanes, missiles, electronics	$4.6	88%

SOURCES: PRUDENTIAL-BACHE; DEPARTMENT OF DEFENSE; COMPANY REPORTS

year did something unique: It got permission from the Air Force to let suppliers meet with flight and ground crews who used their gear. Says Dave Current, a manager of procurement assurance at TI: "There's nothing quite like having a young man who has had to repair your product stand up and say, 'It's your problem, Mr. Components Supplier. You designed it wrong.' "

Sikorsky Aircraft, a unit of United Technologies that makes helicopters, has taken suppliers even farther afield—all the way to Turkey. Sikorsky is bidding on a contract to co-produce, with Turkey, 200 assault helicopters—business Sikorsky hopes will offset its declining U.S. sales. The bidding is intense: Sikorsky is competing against Bell Helicopter Textron from the U.S., as well as French, German, and Italian companies.

In June, Sikorsky took ten suppliers to Istanbul, where they met with senior executives of Turkish manufacturing concerns. The idea was to give the U.S. companies an opportunity to form partnerships. Says James Satterwhite, a Sikorsky vice president: "Our suppliers typically don't have the connections or knowledge about foreign countries that big U.S. companies have." The trip, organized by the Commerce Department, was the first federal trade mission for a single company and its suppliers.

■ PUSHING PRODUCTIVITY. Over the past couple of decades a web of cumbersome and redundant procedures has spread like poison ivy through the factories and warehouses of Wars 'R' Us Inc. GE Aerospace, Boeing, LTV, and TRW all have employees working to weed them out. At TRW's Electronics Systems Group, which builds equipment packages for satellites, employee teams are painstakingly analyzing hundreds of processes in an effort to expose and eliminate inefficiency. Similarly, at LTV's Camden, Arkansas, rocket plant, which turns out as many as 90,000 rockets a year for the Army, workers are looking for ways to make their products cheaper, faster, and better. The incentive: money.

Two years ago the plant's managers introduced a gain-sharing program. Employees were organized in teams, given productivity goals, and told that LTV would split with them fifty-fifty any savings they achieved. LTV also gave classes for workers on how to find and solve problems. The program is a winner. During the first year, the average employee received $1,900 in bonuses. General manager Wilbur Cummings says annual costs plunged 20%—boosting profits and enabling LTV to bid for new contracts at a lower price.

■ CONVERTING TO CIVILIAN SALES. The trick to diversification is finding businesses that play off the strengths of the company, then letting people who know the market run the show. Warns Raytheon Chairman Thomas L. Phillips: "You can't just start with a bunch of people who have done nothing but compete in the military market for 30 years, and sprinkle holy water on them." Hughes Aircraft, which wants to increase its commercial business from 20% to 40% of total revenues, has opened an office for diversification. It is trying to launch small commercial ventures that will match its military electronic products—such as lasers, microwave tubes, and very fast semiconductors—with market needs. In July the company announced the formation of HE Microwave, a joint venture with Delco Electronics, another General Motors subsidiary, which sells auto products. The new company will market sensors for both military radars and futuristic systems to help cars avoid collisions. Hughes predicts that in five or six years sales will top $400 million.

Lockheed, which for many years owned and operated the Burbank airport, wants to build and run airports all over the world. With hundreds of cities and towns in desperate need of airport space, the company thinks this business could be a fountain of cash. Some financial analysts agree. Says Peter Aseritis of First Boston: "The airport concept could be a brilliant growth strategy, if they can get state and local governments to privatize."

The company has begun developing a terminal at Lester B. Pearson International Airport in Toronto. Lockheed is an equity partner and will operate the 1.4-million-square-foot facility, which is set to open this winter. Don Jones, head of Lockheed's Technology Services Group, compares the project to developing a shopping center, only less risky since airports are a monopoly business.

Small defense companies are generally more flexible than big ones when converting to the commercial sector. But often they lack the resources to find opportunities. In Ohio, where 176,000 people work in defense industry jobs and add more than $6 billion a year to the state economy, officials set out to remedy that problem last year. The state sponsored a series of "conversion seminars," which introduce small contractors to purchasing agents from companies such as Honda, Siemens, and General Electric.

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Sands and Lube of Cletronics show off a monitor for cardiac patients.

It was through such a seminar that Cletronics, a Medena, Ohio, company with estimated annual sales of $3 million, went from making camera parts for surveillance planes to medical devices. Chief Executive David Sands bought the company last November, not expecting its Pentagon business to dry up as fast as it did. By year-end, orders dropped from $40,000 per month to practically zero. Through the conversion seminar, President Robert Lube hooked up with the not-for-profit Cleveland Clinic, landing an assignment to develop a pocket-size monitor that warns pacemaker patients of potentially lethal magnetic fields.

Cletronics has also scared up new business from General Electric and even Philips in the Netherlands. Says Lube: "Some companies are sitting back waiting for the government to call, saying, 'I've got an order for you.' That's not going to happen. Defense contractors that aren't aggressive and marketing oriented are going to find themselves on the outside looking in." As is often the case in civilian business, so it now is in defense: Hustling entrepreneurs like Sands and Lube are setting an example that major companies would do well to follow, if they want to prosper. F